SECURE 2.0: What 401(k) Plan Sponsors Need To Know

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Hollywood loves sequels, it's the opportunity to capitalize on a previous hit. The sad fact is that very few movie sequels can be Terminator 2 or The Godfather Part II, they are usually like Caddyshack 2 and Smokey and The Bandit Part 3. It appears that Washington likes retirement plan sequels too with SECURE 2.0, but there are enough things for plan sponsors to consider and how it will affect them.

Automatic Enrollment. Employers who start new plans after December 29, 2022 (the date that SECURE 2.0 was signed into law), beginning in 2025, will be required to automatically enroll participants in their retirement plan at a rate of at least three percent, but not more than 10 percent of compensation. Participants may opt-out by declining to participate. New companies that have been in business for less than three years and employers with 10 or fewer workers are excluded from this requirement. An Automatic Enrollment plan must allow employees to withdraw automatic contributions and any earnings within no more than 90 days of the first contribution without being subject to the 10% penalty on early withdrawals.

Automatic Escalation. Beginning in 2025, for new retirement plans started after December 29, 2022, contribution percentages must automatically increase by one percent on the first day of each plan year following the completion of a year of service until the automatic contribution is at least 10 percent, but no more than 15 percent of compensation. Exceptions will apply for businesses with 10 or fewer employees, and employers that have been in business for less than three years.

Increased catch-up contributions. In 2023, participants age 50 and older can contribute an extra $7,500 per year annually into their 401(k) account. Starting January 1, 2025, individuals ages 60 through 63 years old will be able to make catch-up contributions of up to $10,000 annually to a workplace plan, and that amount will be indexed to inflation. Also, after 2023, all catch-up contributions for participants earning over $145,000 annually must be made on a Roth (after-tax) basis.

Optional Roth Treatment of Employer Contributions. Effective immediately, plan sponsors may amend their plans to permit plan participants to elect that employer matching and profit-sharing contributions are made as Roth (after-tax) contributions, as long as they are 100 percent vested when contributed to the plan.

Change of Eligibility for Long-Term, Part-Time Employees. SECURE 1.0 allows employees who work between 500 and 999 hours for three consecutive years must be allowed to participate in their company's retirement plan (starting in 2024). SECURE 2.0 reduces the time period to two years, effective in 2025.

Student loan debt. Starting in 2024, plan sponsors will be able to "match" employee student loan payments with matching payments to a retirement account, giving workers an extra incentive to save while paying off educational loans. Plan sponsors will be able to rely on the employee to certify annually the amount of their qualifying student loan payments.

Emergency savings. Starting in 2024, 401(k) plans will be able to add an emergency savings account that is a designated Roth account eligible to accept participant contributions for non-highly compensated employees. Contributions would be limited to $2,500 annually (or lower, as set by the plan sponsors) and the first 4 withdrawals in a year would be tax and penalty-free and don't need to be substantiated to show a qualifying emergency. Plan Sponsors may automatically opt employees into these accounts at no more than three percent of eligible wages. Employees can opt out of participation.

Employee contributions to an emergency savings account must be eligible for the same matching contributions that apply for elective deferrals. Matching contributions are made to the 401(k) plan – not to the emergency savings account.

Withdrawals for Certain Emergency Expenses. Usually, a 10 percent excise tax applies to early distributions (usually prior to age 59 ½) from 401(k) plans. In addition to the emergency savings account option described above, beginning in 2024, the Act provides an exception for certain distributions for emergency expenses, which are generally unforeseen immediate financial needs relating to personal or family emergency expenses. Only one distribution is permissible per year of up to $1,000, and a taxpayer has the option to repay the distribution within three years. No further emergency distributions may be made during the three-year repayment period until any amounts previously taken are repaid. The plan sponsor may rely on an employee's written certification that the employee is facing a qualifying emergency personal expense, absent actual knowledge to the contrary.

Expanded Credit for Plan Administrative Costs. Currently, plan sponsors with less than 100 employees may be eligible for a three-year start-up tax credit of up to 50 percent of administrative costs, with an annual limit of $5,000. SECURE 2.0 increases this credit to 100 percent of qualified start-up costs for employers with up to 50 employees. An additional credit of up to $1,000 per employee for eligible employer contributions may apply to employers with up to 50 employees but phases it from 51 to 100 employees.

Saver's Match. Starting in 2027, lower-income employees will be eligible to receive a federal matching contribution of up to $2,000 per year that would be deposited into their 401(k) account. The matching contribution is 50 percent of the employee's salary deferrals but is phased out as income increases. This match replaces the current Saver's Credit.

De Minimis Incentives for Plan Participation allowed. Currently, Plan Sponsors can only provide matching contributions as an incentive for employees to participate in a 401(k) plan. Starting for plan years beginning after 2022, plan sponsors may offer some financial incentives, such as gift cards, to help increase plan participation. However, any financial incentives should be of de minimis amounts (no sports tickets) and can't be paid with plan assets.

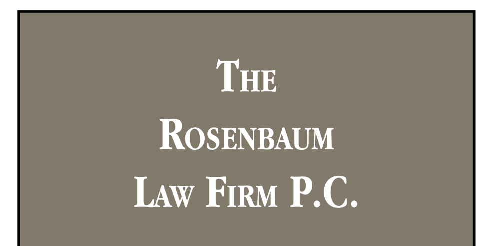
Required Minimum Distributions (RMDs). The requirement to begin taking RMDs will increase from age 72 to age 73 in 2023, and then to age 75 in 2033. Before the original SECURE, the age was 70 ½. This is a nice change since people are living longer. In addition, the penalty for not taking an RMD is reduced from 50 percent of the amount required to be withdrawn currently to 25 percent. The penalty will be reduced to 10% for IRA owners if the account owner withdraws the RMD amount previously not taken and submits a corrected tax return in a timely manner. Additionally, Roth accounts in employer retirement plans will be exempt from the RMD requirements starting in 2024.

Retirement Savings "Lost and Found." Within two years, an online searchable database will be created to allow a retirement plan participant or beneficiary to search for contact information for plan administrators of plans in which the participant or beneficiary may have a benefit. Beginning in 2025, plans will be required to share information with the Department of Labor to be included in the database.

Increase of self-correction. SECURE 2.0 bolsters the self-correction program under the Employee Plans Compliance Resolution System ("EPCRS") to allow more types of errors to be corrected internally (without having to file to the Internal Revenue Service's Voluntary Compliance Program) and to exempt certain failures to make required minimum distributions from the excise tax. There are also new rules for correcting overpayments. These changes are effective immediately.

Increase the cash-out amount. SECURE 2.0 increases the involuntary cash-out limit (where participant consent for distribution is not required), from $5,000, to $7,000. This provision applies to distributions made after December 31, 2023.

Retroactive amendments allowed until tax filing date. SECURE 2.0 will allow retroactive discretionary amendments increasing benefits (except matching contributions) to be made up to the plan's 5500 filing date (or, for single-employer plans, the employer's tax-filing date). Currently, the requirement is that these retroactive amendments must be made by the end of the plan year in which they are effective. This provision is effective for plan years beginning after December 31, 2023.



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